The FOOD MARKETING INDUSTRY SPEAKS 1982

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The FOOD MARKETING INDUSTRY SPEAKS.

In 1981, the nation experienced a challenging but wrenching year. The year brought a new economic philosophy, supply side economics, designed for long-term solutions. But in business, there were short term problems. Although inflation started to slow during 1981, unemployment began to rise. Interest rates remained high. Sales of all industries were flat. In the supermarket industry, productivity and real growth were down.

This report reviews the general economic setting in 1981 as well as the performance of the industry and individual companies in that setting. It covers sales and profit trends, and provides a detailed look at several interest areas. It also provides productivity measures by type of store.

Highlighted this year, for example, are distribution centers —both at the wholesale and retail levels. The report also takes an in-depth look at shopping carts and electronic games.

Much of the data is compiled through FMI's annual surveys of the industry. Detailed explanation of the study is provided in the appendix. FMI gratefully acknowledges all those companies who gave their time and effort to fill out the questionnaires.

Industry information is also drawn from other FMI research reports such as *Operations Review* and *Facts About Store Development*. The Institute would also like to acknowledge data gathered from *Forbes Magazine*, the U.S. Departments of Agriculture and Commerce, and many other business and government publications.

While this report contains the complete analysis for 1981, it does not include the cross-tabulation of survey data from which this analysis was developed. This information, providing a more thorough look at industry activity, is contained in a separate supplemental report entitled *Detailed Tabulations from the Food Marketing Industry Speaks, 1982*. Another publication, *Trends—Consumer Attitudes and the Supermarket, 1982*, parallels *Speaks* by presenting the state of the industry from the consumer side. *Trends* explores consumer attitudes toward the economy and the supermarket, and analyzes changes in consumer concerns and shopping patterns.

Conducted by:

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Washington, DC 20006

IN 1981

Retail Sales Gain	**9.3%**
Wholesale Sales Gain	**11.1%**
Sales Per Square Foot	**$6.75**
Sale Per Transaction	**$14.23**
Sales Per Labor Hour	**$89.00**
Gross Margin With Warehouse	**23.0%**
Gross Margin Without Warehouse	**20.9%**
Net Profit (before taxes)	**1.4%**
Average Weekly Store Sales	**$159,000**

These operating results are typical of FMI's member supermarkets. They represent average performance based on data from a cross-section of our membership.

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The ECONOMIC SETTING

In 1981, the nation had a new president and a new economic philosophy. Supply-side economics became a reality. But 1981 was a time to "wait-and-see" as well, because the supply side approach required long-term patience for long-term solutions.

Some of the pivotal points of President Reagan's 1981 economic program included:

- lowered taxes to create more money for investing in productive parts of the economy rather than in government services;
- reduced government spending and less industry regulation to stimulate creative market forces from the private sector;
- reduced budget deficits so that the private sector doesn't compete for investment money with the government, which is forced to borrow to cover its deficit, thus driving up interest rates; and
- shifted responsibility for social programs to state and local governments, closer to the needs of the people for whom the programs benefit.

It was interesting to watch the President's victories in his program last year. But his programs were not designed to work overnight. And as the year progressed, some very potent obstacles were thrown in the path of the program:

- although inflation lessened significantly, unemployment rose steeply;
- the Federal Reserve retained its tight control of the money supply, which combined with a large Federal deficit means continued high interest rates; and
- two of the largest industries, automobile and housing, continued to sag and create enormous regional and national declining economic pockets.

As Reagan's program proceeds, the year 1982 will be the one to watch. His economic program seeks long-term improvements in the face of some serious short-term economic problems. The key factor will be whether the economy picks up before political forces change the thrust of the program.

Economic Growth

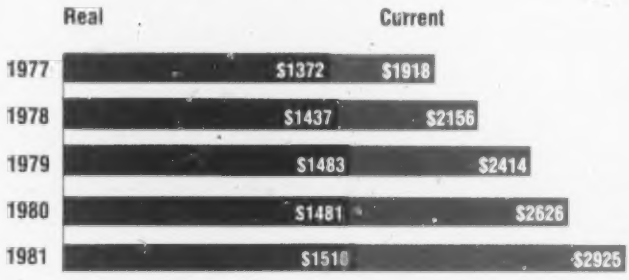
Economic growth in 1981 carried mixed blessings. Compared to previous years where most of the news was weighted on the down side, there was some good news as well.

In 1981, the Gross National Product reached $1.5 trillion in real, or deflated dollars. The GNP is the national production of goods and services. It was good news to see the "no growth" level reversed in 1980 to a real growth level of 2 percent in 1981. At one point observers would have looked at the whipsawing of the GNP from quarter to quarter as unprecedented. But now these fluctuations are viewed as by-products of the many variables in the economy.

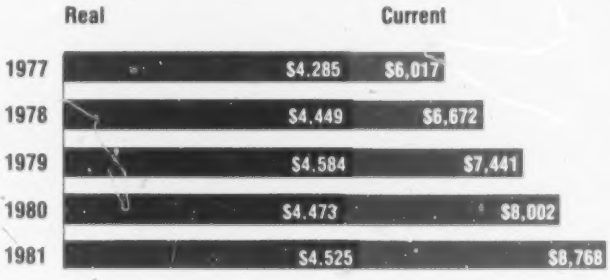
If anything, a fluctuating GNP shows that while the economy is rocky, it nonetheless has some stability. For example, the prime rate has gone up and down with the same velocity as the stock market, making it a tough time to borrow money. Yet some costs may be leveling off, such as in energy, as world oil prices reflect the current glut.

Another positive sign in the economy was the decrease in the inflation rate. The overall inflation rate as measured by the Consumer Price Index was 10.4 percent in 1981. All factors indicate

Gross National Product (Billions)



Per Capita Disposable Income



that the gradual increase in the yearly rate of inflation is on the reverse.

The slowed pace of food price increases is another positive trend. The rate of increase for food-at-home rose 7.3 percent, the lowest rate since 1977. Prices for food away-from-home also slowed to an increase of 9 percent in 1981.

In 1981, consumers spent 16.7 percent of their disposable income on food, with the food-at-home share representing 12.3 percent. These percentages represent slight increases over the previous year for food items at a time when real purchasing power for consumers declined.

One of the more unfortunate sides of the economy was unemployment. Sagging production in the automobile and housing industries took their toll. At the end of 1981, unemployment rose to a rate of 7.6 percent. In the early part of this year its even gotten worse.

Retail Sales

Gradual weakening in consumer spending definitely plays a role in sales. After peaking in the second quarter, sales for all retail stores dropped significantly right through the fourth quarter. The fourth quarter was marked with heavy promotional and price cutting activity in order to prop up sales.

But in the end, grocery store sales trends followed those of all retail stores. Rather than typically rising at the end of the year, fourth quarter grocery sales were the lowest of the entire year.

Restaurant sales did not perform any better. In 1979, restaurant sales started to lag behind grocery sales. For the most part, this trend has continued through 1981.

Food Production

The United States broke all sorts of records with the 1981 feed grain crop. The bumper corn crop of 8.2 billion bushels was up 23 percent from the drought-stricken crop of 1980. As the primary feed grain, the corn crop should help in keeping livestock production costs down. Of course, export policies must be considered.

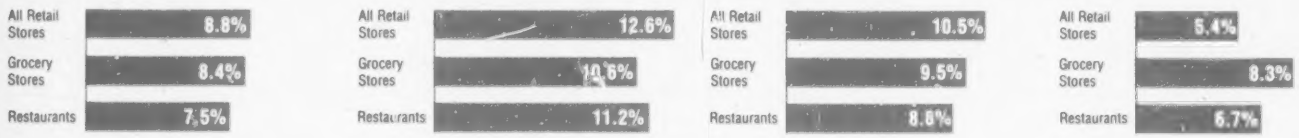
Milk production continued its upward surge—132.2 billion pounds in 1981. The increase in the output per cow was due for the most part to the favorable milk-feed price relationships. As USDA expects this relationship and other factors to remain favorable, the Department anticipates further increases in milk production of one to three percent in 1982. Last winter Americans saw the results of record-breaking milk production. Millions of pounds of milk were processed into cheese, prompting the government's nationwide "Big Cheese Giveaway."

Wheat production was another "bread-winner." The 1981 level climbed to almost 2.8 billion bushels. Although good news in the short-term for consumers, the increased production depressed prices received by farmers, and USDA is not hopeful that exports will remedy this problem for farmers.

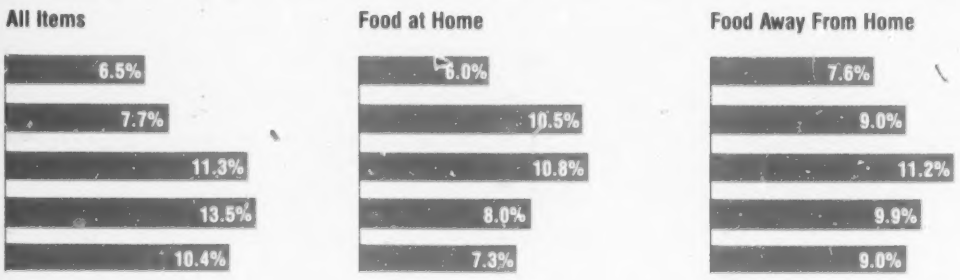
Pork production registered a decline in 1981, at just above 15.7

Sales Increase over '80

By Quarters



Consumer Price Index



billion pounds. Part of this decrease was due to the severe winter weather in 1981. USDA anticipates that less pork, along with little year-to-year changes in competing meat production should strengthen hog prices.

Beef production continued to rise for the second year in a row, to over 22 billion pounds in 1981. The expansion phase of the cattle cycle continued. Part of this expansion has been due to feed grain price relationships. USDA anticipates only slight increases in 1982 production as feedlot profits are expected to be only modest.

Poultry production, including broilers as well as turkeys, rose to 14.2 billion pounds in 1981, in part due to declining red meat prices which caused a reduction in poultry prices. However, USDA anticipates only a modest growth for broilers and a decrease for turkeys in 1982 because of the reduced profits for producers.

In looking at future food prices, USDA forecasts should be viewed with caution. For example, in 1981 USDA economists predicted a 10 to 15 percent increase in retail food prices. The predictions were revised throughout the year as grain crops, domestic consumption and international market influences were measured. By year end, food prices increased only 7.9 percent, reflecting the lowest rise in three years.

In 1982, USDA says the food marketing sector will influence food prices because of rising labor costs. The Department believes that these increases, combined with nominal rises from farm level prices, will push supermarket prices up five to eight percent, with a six percent rise "being more likely."

The INDUSTRY

Wholesaling

Wholesalers are an important part of FMI, both on operations and public affairs issues. They lend strength to their independent operators and to FMI's industry voice.

Sales growth for the average wholesaler rose more modestly in 1981 to 11.1 percent, less than the 14.8 percent in 1980 and 16 percent in 1979. After the inflationary effect is removed, real sales in 1981 grew by 5.5 percent, compared to 5.9 percent in 1980.

The average sales volume per retail store was $2.47 million in 1981. In cooperation with other industry sources, FMI changed its definition of the supermarket to include those with annual sales of at least $2 million. Inflation was the impetus for this change.

In terms of providing services to their retailers, the following predominate the list of services: providing product movement data and individual retail pricing, handling private and generic label merchandise, supplying advertising support and equipment procurement, and reporting gross margin by item. Less than half of the wholesalers were offering lease financing, discounts, and direct store delivery system support.

It is not surprising that 66 percent of the chain stores receive their supplies from their own warehouse. Independents, those with ten stores or less, reported 30 percent affiliation with cooperatives and 22 percent with voluntaries. One major source of supplies to both chains and independents is direct vendor deliveries. These deliveries represent just over 24 percent of chain store volume and over 28 percent for independents.

Retailing

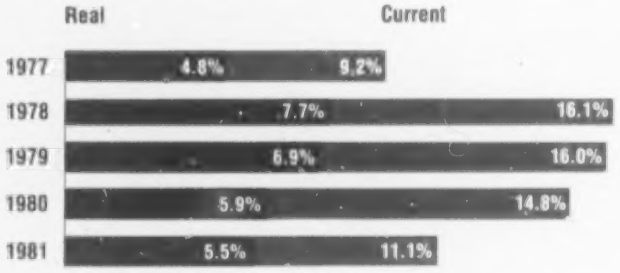
The typical food retailer had a 1981 sales gain of just over 9.3 percent, considerably below the 1980 sales increase. Removing the effect of inflation, the real sales increase dropped significantly, to 3.4 percent. This slow sales growth parallels much of the economic data outlined earlier: sales were flat last year. Although the drop in current sales increase reflects the slowing of inflation, the decline in real sales growth indicates that consumers were also watching their food-at-home budgets.

A comparison of identical stores operated in 1980 and 1981 demonstrates a similar effect. Identical stores registered a 1981 sales increase of just over 8 percent. After accounting for inflation, real identical store sales increased by only 3 percent. The fact that total sales did not measurably increase more than those of identical stores sales indicates that new stores and remodels did not significantly improve industry performance.

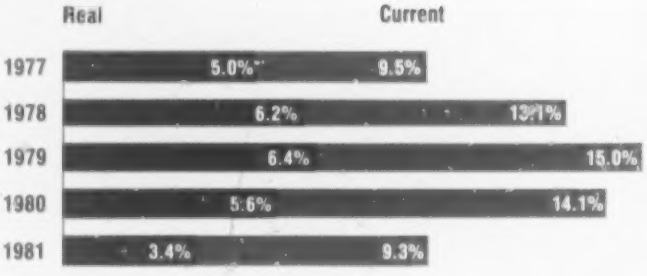
Membership Services Provided by Wholesalers	
Product Movement Data	*100.0%*
Individual Retail Pricing	*100.0%*
Handle Private Label	*95.8%*
Advertising Programs	*87.5%*
Equipment Procurement	*87.5%*
Handle Generic Label	*87.5%*
Gross Margin Report by Item	*83.3%*
Retail Accounting	*75.0%*
Real Estate & Store Engineering	*75.0%*
Equipment & Fixture Financing	*75.0%*
Member Payroll	*66.7%*
Education/Training	*66.7%*
Interior Decor & Design Service	*66.7%*
Scanning Support	*58.3%*
Space Allocation	*58.3%*
Lease Financing	*45.8%*
Discount Program	*45.8%*
DSD System	*45.8%*

In addition to sales, profitability also has a bearing on industry performance. *Forbes Magazine*

Wholesale Sales Increase



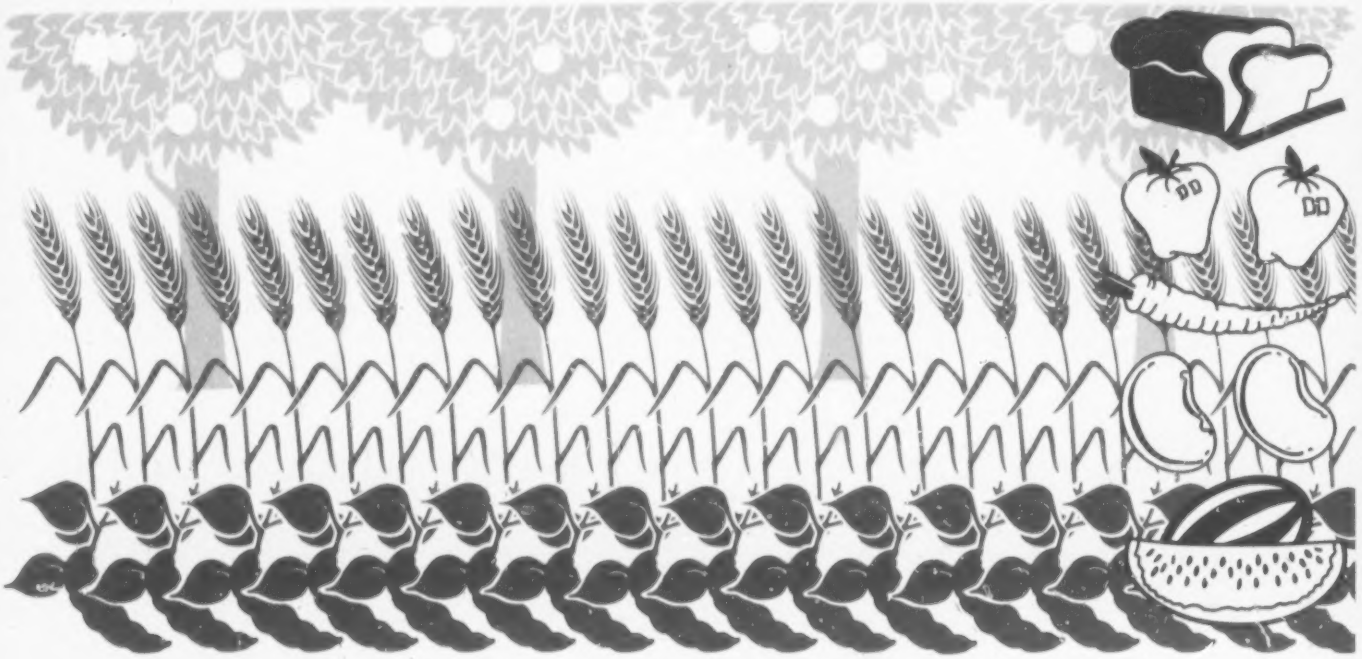
Retail Sales Increase



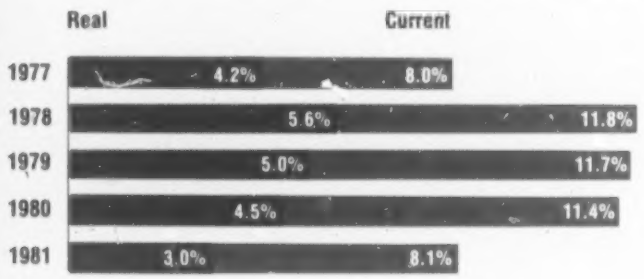
provides an indication of the trend each year in their January issue. For 1981 Forbes reported a return on total assets of 10.2 percent. This figure represents a reversal of the decline in 1980 and demonstrates the industry's highest level of capital productivity in several years.

The return to the owner is best measured by return on net worth. The *Forbes* figures showed a return of 14.8 percent, a level even with 1980. Based on a five-year average return on equity, the supermarket industry ranked 27th of 47 industries surveyed by *Forbes*.

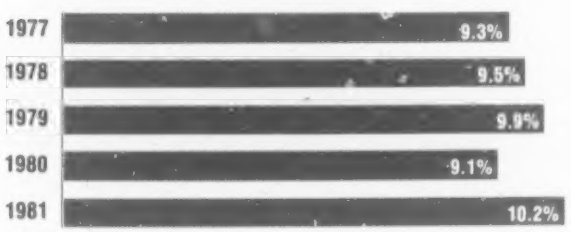
The *Forbes* data are based on only the annual reports of publicly held companies and therefore are not as broad in coverage as FMI's *Annual Financial Review*. The FMI report also breaks down performance by size category. By way of illustration, the 1980 returns on net worth from the FMI report showed that larger firms lost some of the profitability they gained in 1978 and 1979, while smaller firms reached the highest level of profitability in the past several years.



Identical Store Sales Increase

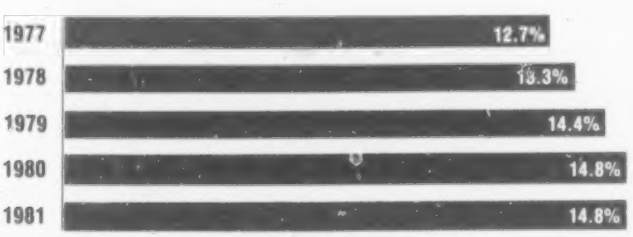


Return On Total Assets*



*Source *Forbes*

Return On Net Worth*



*Source *Forbes*

COMPANY PERFORMANCE

Gross Profit Margin

Gross margin measures the portion of the consumer's food dollar used to cover all operating expenses and profits of the food retailer. It is measured as a difference between the cost of merchandise to the retailer and the amount which the retailer receives upon sales of the merchandise, expressed as a percentage of the retail value.

Companies *without* their own warehouse found that their gross margin stayed at the 1980 level of 20.9 percent. For companies *with* their own warehouse, gross profit margins increased rather substantially, to 23 percent. This figure represents a full percentage-point increase from 1977.

Store-door margins increased just a bit in 1981, to 18.8 percent. This number represents store costs and operating profit only. Inventory shortage, or shrink, averaged .49 percent of sales in 1981. In looking at cost of shrink over the past three years, 1979 appears to have been the worst year.

Net Profit Margin

Unlike gross margins, net profit margins decreased for the second year in a row. Net margins before taxes were 1.4 percent of sales in 1981. A look at net margin by quarters demonstrates that companies had difficulty in all four quarters.

Store Labor Cost

Wage rates climbed very steeply in 1981. The average hourly labor cost rose by over 16 percent to $7.64, significantly greater than the 11 percent increase in 1980. Along with hourly wages, store labor costs also increased. Direct labor costs rose to 8.5 percent of sales, fringe benefits to 2 percent—for total store labor costs of 10.5 percent of sales.

Productivity

Productivity remains a critical concern of the supermarket industry. The three standard yardsticks for measuring productivity this year show improvement at the front-end. Declines were registered, however, due to the expansion in service departments as well as to increases in operating costs for labor and energy.

Sales per square foot in current dollars for 1981 was $6.75. This figure represents a first significant decline, of almost 3 percent, in many years. Removing the effect of inflation, real sales per square foot continued to drop. The 1981 level dropped by 9.5 percent to $2.50 per square foot.

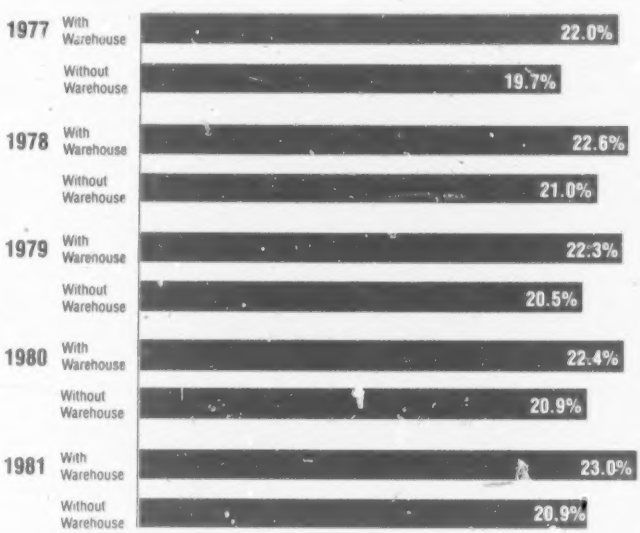
By type of store productivity measures vary. Warehouse stores reaped the highest sales per square foot, at $7.90. Limited assortment stores, which carry the smallest selection of items, were lowest at $3.89 per square foot.

Sale per transaction shows the most dramatic increases in productivity, most likely due to improvement at the front end. Current dollar sale per customer transaction rose a hefty 17.5 percent to $14.23. Real sale per customer transaction reversed its long-term decline. The 1981 level rose by 9.5 percent to $5.27 per transaction.

Looked at by type of store, it is not too surprising to see warehouse stores having the highest sale per transaction, at $20.93. What may be surprising is that conventional stores range up the lowest, at $12.41 per transaction.

Current dollar sales per labor

Gross Profit Margin



Net Profit Margin before taxes